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## 6 Effects on barriers to trade and investment

This chapter assesses the potential impact that bilateral and regional trade agreements (BRTAs) have had on barriers to trade and investment. While the focus is on Australia's agreements, the impacts of other agreements, and the broader lessons, are also considered.

Section 6.1 examines the impact Australia's BRTAs have had on the barriers of member countries. Section 6.2 then examines whether BRTAs have been able to influence overall trade barriers and, in this context, how have they contributed to, or detracted from, global attempts to reduce barriers.

### 6.1 To what extent do BRTAs reduce barriers for members?

There are a number of ways in which agreements can reduce trade and investment barriers, including:

- reductions in tariffs on merchandise trade;
- reductions in non-tariff barriers on merchandise trade;
- reductions in barriers to services trade; and
- reductions in barriers to investment.

While many reductions in these areas operate 'at-the-border', there is an increasing tendency to also include behind-the-border measures in trade agreements — that is, measures focused at domestic policy issues, but which may indirectly restrict the ability of foreign competitors to operate in domestic markets. This section principally examines the impacts of Australia's BRTAs on 'at-the-border' barriers. Some specific behind-the-border provisions are discussed in chapter 10.

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## Reductions in tariffs on goods

### *Tariff concessions under preferential agreements*

One of the most readily identified outcomes of any trade agreement is its effect on tariffs on merchandise trade. In some cases, particularly in relation to certain agricultural products, agreements can also affect tariff quotas. Overall, preferential agreements tend to result in the reduction of tariffs between partners. Australia's agreements, excluding its early non-reciprocal agreements with Pacific Island countries, generally contain commitments by all members to reduce tariffs on at least 95 per cent of tariff lines — a threshold advocated as representing consistency with the 'substantially all trade' coverage provisions stipulated under GATT Article XXIV (box 4.2). Deviations from this level of commitment are restricted to a small number of countries in the AANZFTA. Commitments are also tempered by the use of phase-in periods and exemptions. All recent agreements, except SAFTA, use phase-in periods for tariff reductions, in some cases of up to 20 years. Exemptions, while representing a small number of tariff lines, tend to be in sensitive sectors with relatively high levels of protection.

The nature and timing of tariff reductions and changes in tariff quotas vary between agreements entered into by Australia.

### *ANZCERTA (New Zealand)*

Following its inception in 1983, ANZCERTA resulted in the complete reduction of tariffs to zero by both parties on merchandise trade complying with the agreement rules of origin (RoO) by 1990.

### *SAFTA (Singapore)*

Under SAFTA, both countries reduced all tariffs to zero upon entry into force in 2003. However, Singapore already had few existing tariff barriers, with only a small number of alcohol product tariff lines gaining any tariff concessions.

### *AUSFTA (United States)*

In regards to manufactured goods, both countries reduced most remaining tariffs to zero immediately upon entry into force in 2005, leading to approximately 97 per cent of tariff lines being duty free. Remaining non-zero tariff lines (clothing and textiles) will be phased to zero by 2015.

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For Australian agricultural exports to the United States, the tariffs on two thirds of line items were set to zero immediately, with some further reductions phased in over 18 years. There will be some expansion in the tariff quota for beef, while the out-of-quota tariff will be phased to zero (from 26.4 per cent) between years 9 and 18 of the agreement. Dairy tariff quotas were expanded but out-of-quota tariffs are retained. There were also no changes in market access for sugar.

There are some safeguard measures in the agreement that potentially erode the tariff reductions. For instance, either party can undertake emergency action on clothing and textile products, by increasing the duty to the most-favoured-nation (MFN) rate, if preferential tariff concessions lead to an increase in imports that are determined to threaten the domestic industry. Australian horticultural products exported to the United States face price-triggered safeguards for particular products or product groups and there are quantity-triggered safeguards on beef during the tariff phase-out period, with a price-triggered safeguard from year 19.

#### *TAFTA (Thailand)*

Thailand had relatively high tariff rates, with few duty free tariff lines and some relatively high tariff peaks. For example, automotive tariffs were up to 80 per cent, while beef tariffs were 51 per cent. Around half of Thailand's tariffs on complying Australian imports were reduced to zero upon entry into force in 2005. A substantial proportion of remaining tariffs were phased to zero by 1 January 2010, with most remaining tariffs to be phased to zero by 1 January 2015. Border restrictions on some agricultural products such as beef will not be phased out until 2020, while designated dairy tariff quotas will not be abolished until 2025.

Australia will reduce all tariffs on imports from Thailand to zero by 2015. Under the agreement, tariffs on motor vehicles were cut to zero upon its entry into force.

#### *ACI-FTA (Chile)*

Most tariffs on both sides were reduced to zero on the agreement entering into force in 2009, with most tariffs to be phased out by 2015 — Chile's sugar tariff is the exception.

#### *AANZFTA (ASEAN and New Zealand)*

Under this regional agreement, the extent of tariff reductions varies between members (table 6.1). In general, the less developed economies have longer phase-in periods and are subject to lesser reductions, or in some cases, the binding of tariffs

**Table 6.1 Percentage of zero HS6 tariff lines for AANZFTA members**

<i>Country</i>	<i>2005 (Base Tariffs)</i>	<i>2010</i>	<i>2013</i>	<i>Final tariff elimination</i>	<i>Year achieved</i>
	%	%	%	%	
Australia	47.6	96.4	96.5	100.0	2020
Brunei	68.0	75.7	90.0	98.9	2020
Burma	3.7	3.6	3.6	85.2	2024
Cambodia	4.7	4.7	4.7	88.0	2024
Indonesia	21.2	58.0	85.0	93.2	2025
Laos	0.0	0.0	0.0	88.0	2023
Malaysia	57.7	67.7	90.9	96.3	2020
New Zealand	58.6	84.7	90.3	100.0	2020
Philippines	3.9	60.3	91.0	94.6	2020
Singapore	99.9	100.0	100.0	100.0	2009
Thailand	7.1	73.0	87.2	99.0	2020
Vietnam	29.3	29.0	29.0	89.8	2020

Source: DFAT (2010a).

at 2005 applied levels. Only Australia, New Zealand and Singapore will eliminate tariffs on all qualifying goods from AANZFTA members. For some members of this agreement, tariffs will be eliminated on less than 95 per cent of tariff lines.

The entry of this agreement into force means that Australia now has two agreements with each of New Zealand, Singapore and Thailand that Australian exporters can potentially use to obtain tariff concessions. While tariff outcomes for Singapore are the same, reductions are generally phased in sooner under the pre-existing bilateral agreements, and in the case of Thailand, there are some tariffs that will be eliminated under TAFTA, but not AANZFTA.

Overall, while Australia's recent bilateral and regional trade agreements may not involve the complete removal of tariffs, these preferential agreements have nevertheless resulted in the negotiation of some appreciable reductions in tariff barriers faced by Australian suppliers in partner countries.

For imports into Australia, while starting from a base of generally very low tariffs, there have been widespread reductions to those tariffs for complying imports from agreement partners, potentially lowering costs for Australian firms.

The effect of tariff reduction commitments in preferential agreements is indicated by observed changes in the average tariffs between Australia and its trade agreement partners (table 6.2). Because agreements were only signed relatively

recently and agreed tariff reductions are often subject to phase-in periods, the full extent of reductions in tariff barriers is yet to be realised for all agreements.

**Table 6.2 Change in average applied tariffs on bilateral trade between Australia and trade agreement partners<sup>a</sup>**

	<i>Exports from Australia</i>			<i>Imports to Australia</i>		
	<i>Year</i>	<i>Simple average</i>	<i>Weighted average</i>	<i>Year</i>	<i>Simple average</i>	<i>Weighted average</i>
		<i>%</i>	<i>%</i>		<i>%</i>	<i>%</i>
Singapore	2001	0.0	0.0	2002	4.5	0.8
(SAFTA)	2008	0.0	0.0	2008	0.0	0.0
Thailand	2004	11.5	2.5	2002	6.2	4.8
(TAFTA)	2008	10.3	1.5	2008	1.6	0.4
United States	2002	3.8	2.1	2002	4.6	2.6
(AUSFTA)	2008	1.0	0.1	2008	1.2	0.1

<sup>a</sup> Data not available for certain agreements due to their relatively recent implementation. Simple average is the average tariff across all tariff lines. Weighted average is weighted by the share of imports from the partner country for each tariff line.

Source: Commission estimates using World Integrated Trade Solution (WITS) data.

FINDING 6.1

*Australia's preferential trade agreements contain commitments to reduce and bind at zero tariffs on most items of merchandise trade between agreement partners, although sensitive sectors are sometimes excluded or subject to lengthy phase-in periods.*

**Tariff reductions on a non-preferential basis**

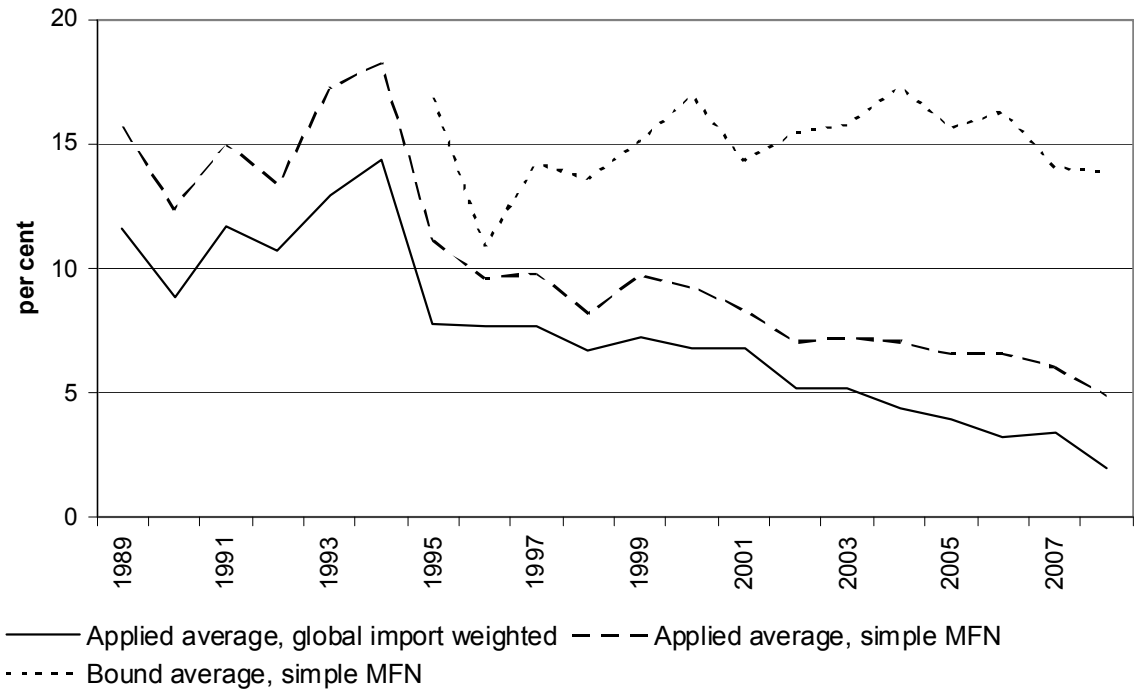
While the APEC Bogor declaration did not place binding obligations on members to reduce their trade barriers, it did involve the announced intention by APEC members to reduce tariffs and other barriers to trade on an MFN basis:

To strengthen the open multilateral trading system we decide to accelerate the implementation of our Uruguay Round commitments and to undertake work aimed at deepening and broadening the outcome of the Uruguay Round. We also commit ourselves to our continuing process of unilateral trade and investment liberalization. As evidence of our commitment to the open multilateral trading system we further agree to a standstill under which we will endeavour to refrain from using measures which would have the effect of increasing levels of protection. (APEC 1994, p. 1)

Following the declaration in 1994, and coinciding with the implementation of the WTO Uruguay Round commitments, there was a substantial fall in tariffs among APEC members (figure 6.1). In general, available information suggests that APEC

members have gone beyond their Uruguay commitments and towards the objectives announced in the Bogor Declaration. Applied tariffs are below rates bound under the Uruguay Agreement and have continued to trend down, leading to a significant difference between bound and applied rates. While showing a similar trend, there is some difference between simple and trade weighted average applied tariffs, with the latter being lower as a result of trade being concentrated in items attracting a lower duty.

**Figure 6.1 APEC members' average tariff rates<sup>a</sup>**



<sup>a</sup> Some of the variation between years in average tariff rates is caused by changes in the number of APEC countries reporting (including as a result of changes in APEC membership) and variation in tariff structures between countries. Because the trade weighted average tariff is calculated using trade data for each year as weights, some of the change in the trade weighted tariff is also due to changes in the composition of trade.

Source: Commission estimates using World Integrated Trade Solution (WITS) data.

FINDING 6.2

*APEC members have unilaterally reduced general tariffs on merchandise trade beyond their Uruguay Round commitments and have made substantial progress towards Bogor Declaration trade liberalisation goals.*

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## **Reductions in non-tariff barriers**

In addition to tariffs, BRTAs typically contain provisions relating to non-tariff barriers including sanitary and phytosanitary measures, technical barriers to trade and customs procedures. Coverage of these issues is generally similar between agreements and in some cases simply affirms existing commitments under the WTO. For example, under AANZFTA, members agree to determine the customs value of goods in accordance with the WTO Agreement on Customs Valuation.

Trade facilitation is also an important objective of regional agreements such as APEC. In support of the Bogor Declaration, in 2001, APEC members endorsed the APEC Principles on Trade Facilitation. The principles cover areas such as: transparency; consultation; simplification of rules and procedures; non-discrimination; consistency, harmonization and standardisation (including mutual recognition); modernisation; and cooperation (APEC 2001).

## **Reduction in barriers to trade in services**

Many of the barriers facing services trade are behind-the-border barriers, such as regulatory and institutional arrangements that restrict competition. As discussed in chapter 9, many of these barriers effectively lie beyond the reach of BRTAs. Nevertheless, there are a range of barriers to trade in services that countries might seek to address through BRTAs.

DFAT submitted that, in pursuing the services component of agreements, Australian negotiators have sought a number of objectives, including:

- securing the binding of existing levels of market access;
- negotiating new market access in sectors of priority commercial interest;
- most-favoured-nation (MFN) commitments to ensure we gain the benefits offered to future FTA partners of our FTA partners;
- improved transparency;
- disciplines on domestic regulation (standards, licensing, recognition of qualifications);
- commitments to treat services investors at least as well as investors in goods sectors;
- separate chapters on sectors of particular interest e.g. telecommunications, financial services, education and movement of natural persons; and
- a ratchet mechanism to ensure that future autonomous liberalisation by FTA partners is locked in. (sub. 53, p. 26)

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Reflecting this approach, recent agreements entered into by Australia typically contain some or all of a standard range of provisions such as:

- National treatment: this provision calls for foreign service providers to be afforded treatment no different to that afforded to domestic service providers.
- Market access: these provisions relate to restrictions on the operation of foreign service providers, such as restrictions on the number of foreign operators, number of employees or value of operations.
- Commercial or local presence: these provisions relate to restrictions on the ability of a foreign service provider to establish a commercial presence, or the need for foreign service providers to meet local presence requirements — such as a local office, or residency requirements — to supply a service.
- MFN treatment: under this principle, parties agree to afford to foreign service suppliers of a partner country, no less favourable treatment than that they afford to foreign service suppliers of another country.
- Ratchet mechanisms: these are used to bind any future concession that a party may make unilaterally.

In many cases, however, services chapters in BRTAs do not lead to preferential reductions to existing barriers in partner countries. As DFAT noted:

In contrast to tariff negotiations ... services negotiations in FTAs do not necessarily create new preferential market access opportunities for Australia's services exporters. The more likely FTA outcome is the binding of existing levels of openness ('standstill commitments') ... (sub. 53, p. 27)

The coverage of services within agreements is typically specified either through a positive list approach (only specified items are covered) or a negative list approach (only specified items are not covered) (box 6.1). Commitments on reductions in services barriers in Australian agreements vary, although those agreements that adopt the negative list approach contain larger overall reductions in barriers to trade in services. Key aspects of each agreement are summarised below.

- ANZCERTA (New Zealand) — the services protocol to ANZCERTA includes provisions such as national treatment, market access, rights of commercial presence and MFN treatment. It provides for free trade in services, except for those listed exceptions. The list of exemptions has been progressively reduced with the only exceptions remaining in the areas of air services, broadcasting, third party insurance, postal services and coastal shipping for Australia, and air services and coastal shipping in the case of New Zealand. The agreement adopts a negative list approach such that any new services are automatically subject to the provisions of the protocol.

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## Box 6.1 Negative and positive list approaches to services

There are two different approaches that are used in setting the coverage of service provisions within BRTAs:

- The negative list approach. Under this approach, all market access barriers and deviations from national treatment are eliminated with the exception of sectors that are scheduled as 'non-conforming exceptions'. This approach is applied in agreements such as NAFTA, AUSFTA and ANZCERTA.
- The positive list approach. Under this approach, market access and national treatment obligations only apply to scheduled services, with non-scheduled sectors remaining unaffected by the BRTA. This approach is specified in the GATS and is applied in agreements such as AANZFTA.

There are a number of advantages attributed to the negative list approach. First, its coverage is, by default, more extensive than that afforded by the positive list approach. Because everything is covered except for specifically listed exceptions, this approach may better comply with Article V of the GATS, which requires agreements to have substantial sectoral coverage. Another advantage is that it is more transparent, because it is clear what the regime of non-conforming exceptions is, whereas under the positive list approach, details of the restrictions or discriminatory rules that apply to non-scheduled sectors may not be readily available to foreign service providers.

While the positive list approach does not share these advantages, it is sometimes favoured because it provides countries with a clearer picture of the commitments being entered into and may be regarded as more manageable, given the development of a country's regulatory frameworks and institutions. Some participants voiced a preference for this approach. For instance, the Australian Council of Trade Unions submitted that:

The positive list approach is the best way to avoid unintended, unforeseen and excessive liberalisation by:

- Preventing the automatic application of liberalisation obligations to services that do not exist nor were contemplated at the time the agreement is negotiated
- Preventing inappropriate restrictions on the rights of government to regulate in the public interest
- Not limiting the regulatory options of future governments when, and after, the new services emerge
- Checking unidirectional policy movement (towards comprehensive liberalisation) because variances to the 'negative list' annex cannot be reversed to the status quo once variance to the existing arrangements are made (sub. 19, p. 4)

While the negative list approach is generally thought to be more liberalising, this may not always be the case if listed exemptions are extensive or complex. Moreover, while the sectoral coverage may be narrower under the positive list approach, there may be substantial reductions in barriers in those sectors that are covered. However, in practice, it is unlikely that agreements using a positive list approach would be more liberalising than those adopting the negative list approach. Where feasible, and provided that comprehensive information on the implications is available to the government and parliament, the Commission generally supports use of a negative list approach.

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- SAFTA (Singapore) — includes provisions on market access, national treatment and transparency. The agreement adopts the negative list approach, but there are considerably more exclusions than in the case of ANZCERTA. Outcomes on residency requirements for professionals, removal of some quantitative restrictions, such as the number of wholesale banking licences in Singapore available to Australian banks and provision of a framework for the development of mutual recognition agreements (MRAs) were the key outcomes for Australia from the agreement.
  - AUSFTA (United States) — under AUSFTA, each party must afford national treatment to the other, not impose local presence requirements and meet market access provisions. Parties are also bound to MFN treatment. The agreement adopts the negative list approach. While exclusions do not appear to be as extensive as under SAFTA, there are considerably more than in ANZCERTA. The agreement includes a framework for developing MRAs, including through the development of a Working Group on Professional Services.
  - TAFTA (Thailand) — commitments with regard to services are less comprehensive than those under the agreements already discussed. The agreement uses a positive list approach and hence only provides for specific concessions, rather than specific exemptions. The agreement called for the parties to enter into further negotiations within three years of entry into force, although this is yet to occur.
  - ACI-FTA (Chile) — as with the AUSFTA agreement, this agreement contains provisions on market access, national treatment, local presence and MFN treatment. It also uses the negative listing approach and has a ratchet mechanism to lock in future reductions in barriers to services trade.
  - AANZFTA (ASEAN and New Zealand) — this agreement uses the positive list approach, with national treatment and market access obligations applying only for sectors listed in the agreement and subject to listed conditions. There is no automatic MFN provision, but scope for consultation of more favourable treatment is extended to another party. The agreement stipulates that a review process will be commenced within three years with a view to progressively extending commitments.

FINDING 6.3

*Australia's BRTAs typically contain provisions addressing aspects of trade in services, but these do not necessarily lead to significant reductions to services barriers in partner countries. In a number of areas, the main impediments to effective competition by Australian services providers in partners' services markets are related to regulatory and institutional issues that lie outside the scope of BRTAs.*

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There have also been attempts to lower barriers to trade in services through forums such as APEC. One outcome of such attempts is the APEC Business Travel Card which is aimed at streamlining business migration by removing the need to individually apply for visas to participating APEC members. All APEC economies, except Russia, participate in the scheme, although Canada and the United States are only transitional members and retain additional requirements with respect to visas.

## **Reductions in investment barriers**

Traditionally, agreements on investment have been undertaken through specific bilateral investment treaties (BITs). Currently there are over 2000 BITs in operation and Australia is party to 20 of these treaties. Australia's BIT partners are all developing countries (ICSID 2010). In general, BITs focus on post-establishment issues. BRTAs typically include the same provisions as those found in BITs, covering topics such as: provisions on national treatment; MFN treatment; transfers; expropriation; and investor-state dispute settlement.

As for services, the extent of the reduction in barriers is difficult to quantify and examples of business benefiting from reductions in barriers to investment are less common than for reductions in tariff barriers on goods trade. Commitments on reductions in investment barriers are summarised below.

- ANZCERTA (New Zealand) — as yet, the agreement contains no specific provisions on investment.
- SAFTA (Singapore) — the agreement covers a range of investor protections, including provisions on national treatment, transparency, expropriation and nationalisation, compensation for losses and transfer of investors' funds. The agreement does provide for investor-state dispute settlement.
- AUSFTA (United States) — the agreement provides for national treatment, MFN treatment and a minimum standard of treatment in accordance with customary international law. The agreement does not include provision for investor-state dispute settlement. The most prominent change under the agreement is the change in Australia's screening thresholds for foreign investment from the United States.
- TAFTA (Thailand) — the agreement includes provisions on national treatment, MFN treatment, expropriation, compensation for losses and transfers. The agreement includes provision for investor-state dispute resolution. TAFTA also included some changes to foreign investment restrictions, allowing for majority Australian ownership — up to 60 per cent, or in some cases 100 per cent, up from 49.9 per cent — for various business types, including mining, and construction services.

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- ACI-FTA (Chile) — the agreement includes provisions on national treatment, MFN treatment, minimum standard of treatment in accordance with customary international law, transfers, treatment in case of strife and expropriation. The agreement also provides for investor-state dispute settlement.
  - AANZFTA (ASEAN and New Zealand) — the agreement covers post-establishment elements of investment and provides for protection of foreign investors through provisions covering: national treatment; fair and equitable treatment and full protection and security (in line with customary international law); non-discriminatory treatment for investors who suffer losses due to armed conflict, civil strife or states of emergency; free transfer of funds; and compensation for expropriation or nationalisation and transparency. The agreement also provides for investor-state dispute settlement, but not between Australia and New Zealand. The agreement also provides for a work program to attempt to include pre-establishment market access issues, such as foreign equity limits within five years of commencement.

One of the most prominent examples of foreign investment barriers being affected by BRTAs is that of the increase in the thresholds above which US investments in Australia are subject to screening by the Foreign Investment Review Board (FIRB). Under AUSFTA the threshold for investing in non-prescribed Australian businesses above which approval is required has been raised to \$1004 million for US investors, compared with \$231 million for all other foreign investors.<sup>1</sup>

The extent to which this represents a reduction in barriers to investment is not clear. On the one hand, there is a view that FIRB approvals are relatively routine and only impose a relatively minor transaction cost on foreign investors. For instance, in 2008-09, of the 5355 applications considered (of which over 90 per cent related to residential real estate), there were only three rejections (all in relation to residential real estate). For non-residential real estate approvals, only five were subject to conditions (FIRB 2010). Hence, the increase in the threshold may not represent a substantial reduction in investment barriers. On the other hand, there are arguments that the presence of FIRB creates a perception of increased sovereign risk and may deter some investment in Australia.

In its assessment of AUSFTA, the Centre for International Economics (CIE 2004a) argued, along these lines, that even where proposals were not rejected, the presence of the threshold could act as a deterrent and could contribute to an equity risk premium on investing in Australia, increasing the cost of capital. The restrictiveness index score for Australia calculated by the OECD (box 6.2), which gives a high

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<sup>1</sup> Other thresholds apply for other classes of investment.

weighting to the FIRB screening arrangements, adds to the impression that there is scope for material barrier reductions through reform of those arrangements.

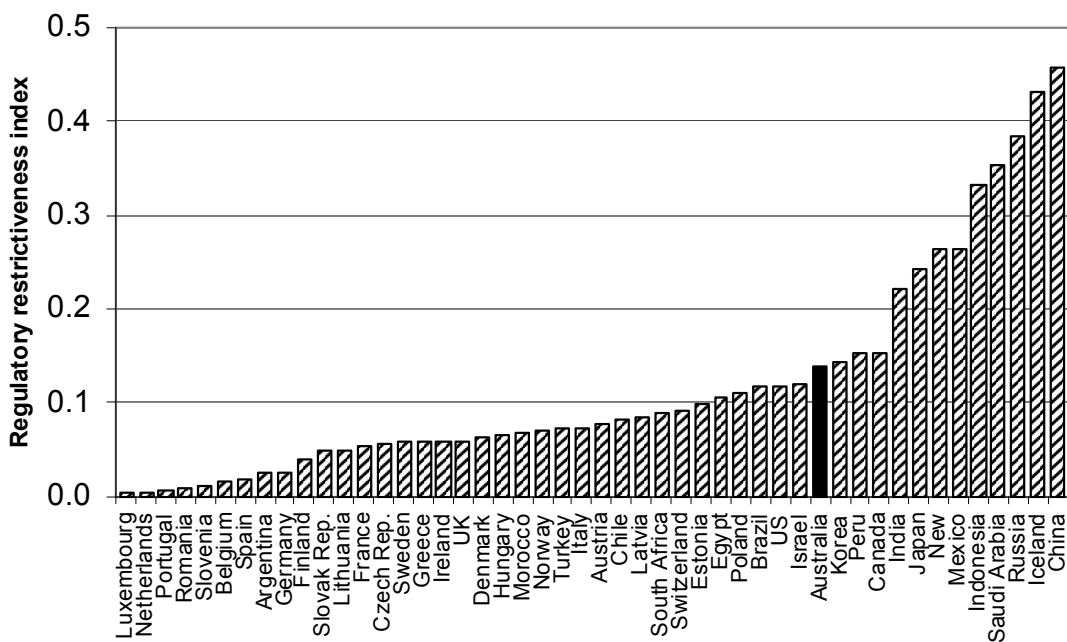
### Box 6.2 International comparison of FDI restrictions

Many of the barriers to investment are behind-the-border measures that affect the actual or perceived riskiness faced by foreign investors and are inherently difficult to quantify. One attempt to quantify and compare investment barriers is the foreign direct investment (FDI) regulatory restrictiveness index compiled by the OECD secretariat.

The index has been calculated for both OECD countries and a number of non-OECD members. The index attempts to measure the deviation from national treatment for foreign investors, where 0 represents full openness and 1 a prohibition on FDI.

While the index provides a heuristic approach by which FDI regimes can be compared on a common basis across countries, according to the compilers of the index, the approach has a number of limitations. In particular, the index has limited sectoral coverage — it is calculated at the industry level for 9 sectors and 11 sub-sectors, and then aggregated to provide a weighted national average. There are also some difficulties in ranking countries, and the authors caution that the index should not be used in isolation.

Having regard to these limitations, the index provides an indication of how Australian barriers compare with those of other countries. On an international scale, Australia's investment barriers are in the mid-range. Australia's score can, in large part (according to the measures contained in the index) be attributed to Australia's FIRB screening arrangements.



Source: Kalinova, Palerm and Thomsen (2010).

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Investment provisions in BRTAs can also address sovereign risk. Agreements that provide pre-establishment protections are one means of insulating investors against future changes to foreign investment policies in partner countries.

FINDING 6.4

*In most agreements, investment provisions in Australia's BRTAs have bound current arrangements and provided protections against future policy changes rather than reducing existing investment barriers.*

### **Limits on realising reductions in trade and investment barriers**

As noted in the above discussion, BRTAs can result in the reduction of trade and investment barriers, either preferentially or on an MFN basis, depending on the nature of the agreement and the provisions embodied in particular agreements. However, the extent to which reductions in barriers can be utilised in practice can vary. One potential source of limitation is the operation of RoO. In addition, other barriers, such as quarantine measures, limit the ability of businesses to respond to reductions in tariffs.

#### *Rules of origin*

RoO are incorporated in preferential trading agreements (PTAs) to determine whether goods entering from the partner country qualify for preferential tariff treatment. That is, they restrict the availability of preferential entry to goods deemed to originate from the partner countries. In the absence of RoO, there would be an incentive (tempered only by the costs of transshipment) to import goods from a third country into the PTA region through the member with the lowest MFN tariffs in order to take advantage of the duty concessions within the region. In seeking to limit the availability of preferences to goods originating from the partner country, one effect of RoO is that they can claw back some of the liberalising effects that would otherwise pertain from the tariff reductions contained in PTAs.

Assessing origin can be difficult because production processes for many goods are now typically fragmented and can use inputs sourced from several countries. Moreover, the nature and potential sources of inputs are continually changing, as is the technology and organisation of production itself. In these circumstances, governments are forced to rely on negotiated RoO that attempt to reconcile the goals of the particular trade agreement.

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There are three common tests for determining origin:

- The change in tariff classification (CTC) test — a good is transformed if there is a change in tariff classification, using the Harmonized Commodity Description and Coding System. The CTC method can be applied at the 8-digit, 6-digit, 4-digit or 2-digit level of classification.
- The specified process test — a good is transformed if it has undergone specified manufacturing or processing operations which confer origin of the country in which they were carried out.
- The regional value content (RVC) test — a good is transformed if a threshold percentage value of locally or regionally produced inputs is reached in the exporting country.

RoO are also often subject to considerable ‘fine print’ and special rules for particular tariff items are common.

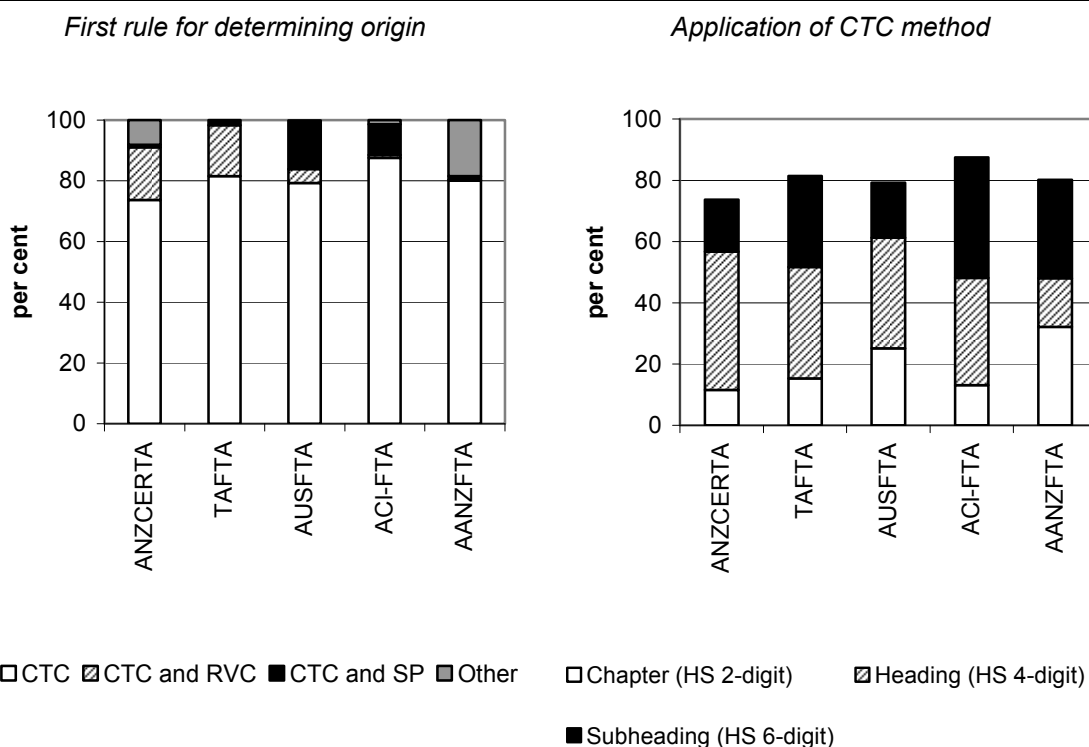
The composition of RoO vary across agreements. Analysis of some of Australia’s recent agreements demonstrates the diversity of approaches for conferring origin that businesses must consider when sourcing inputs to attain concessional access for their products (figure 6.2).

The most frequent rule of origin (in Australia’s most recent agreements) is the CTC test. However, agreements often, but not always, specify rules of origin which require application of more than one rule (for example, a combination of a CTC rule and a RVC rule) or a CTC rule with an exception, which narrows the scope of the CTC rule by carving out specific products. SAFTA (which is not included in figure 6.2) only applies a single two-tiered test of origin. The first tier requires that the product be ‘manufactured’ in the member countries. The second tier requires the application of a regional value content rule.

Examining the individual agreements shows that Australia’s agreements with the United States and Chile contain a relatively high proportion of CTC rules with specified process tests — approximately 16 and 10 per cent, respectively, of rules for items with a non-zero MFN rate in the Australian tariff. While the agreements with New Zealand and Thailand each contain less than 3 per cent of CTC rules with specified process tests, these agreements have higher proportions of CTC rules with regional value content tests — around 17 per cent, for both agreements, for items with a non-zero MFN rate in the Australian tariff.

**Figure 6.2 Summary of methods used to determine origin in recent preferential trade agreements entered into by Australia<sup>a</sup>**

Per cent of 6-digit HS items with non-zero MFN rates in the Australian tariff



<sup>a</sup> CTC refers to a change in tariff classification test. SP refers to specified process tests that require particular production methods to be used (within the territory of the PTA) to qualify for preferential entry. RVC refers to a regional value content rule. The CTC statistics for AANZFTA relate to the proportion of total rules where a CTC option is available (but not necessarily the first rule). The CTC rules for ANZCERTA came into effect in 2007, however, business can still elect to use the pre-existing RVC approach.

Source: Commission estimates.

The RoO for ANZCERTA are about to be changed again. Under changes tabled in parliament on 21 June 2010, rules will be brought closer into line with the RoO of Australia's more recent agreements (Crean and Carr 2010). This will result in more CTC-only rules, although for some lines there will be a choice of CTC or RVC rules. Further, the option to use the original RVC approach that has been available since the agreement's inception will be abolished from 1 January 2012. Until that time, producers can demonstrate origin either on the basis of the product specific (predominately CTC-based) rules or the old RVC rule.

The variation in composition of RoO across different agreements means that some products will be required to meet different RoO to utilise preferences across agreements.

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While RoO can be necessary to prevent transshipment where there is sufficient variation in tariffs amongst PTA members, RoO can be unnecessarily restrictive. One example of a restrictive RoO is the ‘yarn forward’ rule found in NAFTA, which requires that for clothing and textile products, all steps forward from the formation of the yarn used in the fabric be conducted within the trade agreement area.

Because of these different approaches to implementing RoO, it is likely that some BRTAs will have more trade-creating RoO regimes than others.

### *Non-tariff barriers*

As noted earlier, BRTAs often include provisions aimed at addressing non-tariff barriers to trade, such as quarantine and customs procedures. Nevertheless, the continued presence of non-tariff barriers can mean that some potential reductions in trade and investment barriers, such as tariff concessions, are not realized. In particular, in the case of agricultural products, access is subject to the establishment of quarantine protocols that are negotiated in line with the WTO Sanitary and Phytosanitary Agreement. The lack of protocols for particular products with trade agreement partners can prevent trade, despite reductions in tariff barriers, as noted by the Office of Horticultural Market Access:

Tariff and border access liberalisation under bilateral and regional agreements will, to a significant extent for horticulture, remain unrealisable unless improved phytosanitary access is also achieved. Liberalised border access is negotiated under bilateral and regional agreements whether or not phytosanitary access is in place. (sub. 39, p. 7)

Behind-the-border measures are also a common source of additional impediments that can restrict realisation of the benefits from tariff reductions. In some cases, changes to other policies can occur after agreements are signed, and can be perceived as attempts to cancel out agreement concessions. For example, the Australian Industry Group cited the case of Australian automotive exports to Thailand:

... Thailand has instituted measures relating to passenger motor vehicles which significantly reduced the potential for Australian vehicle exporters to benefit from TAFTA. Thailand’s restructuring of motor vehicle excise tax applies the new excise rates on a non-discriminatory basis to all exporters. However, the fact that the rates escalate according to engine size disadvantages Australia. (sub. 7, p. 6)

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## 6.2 Broader effects of BRTAs on trade and investment barriers

While some specific trade and investment barriers have been reduced — and trade facilitation measures introduced — under BRTAs, they can also have broader impacts on trade and investment barriers. BRTAs can potentially affect the capacity to reduce barriers multilaterally or unilaterally. Additionally, existing BRTAs can impact on the formation of future BRTAs.

### Reducing barriers multilaterally

While many of the issues addressed in BRTAs are ‘WTO-plus’ — that is, they are beyond the scope of issues considered within the multilateral WTO framework — there is a long-standing contention as to whether BRTAs, particularly those that reduce trade and investment barriers on a preferential basis, promote or inhibit global trade liberalisation. That is, are they ‘building blocks’ or ‘stumbling blocks’?

#### *Building blocks?*

The potential for agreements to act as building blocks towards further multilateral reform of trade and investment barriers will depend on the nature of particular agreements. Further, there are a multitude of ways in which these agreements can potentially influence broader efforts to achieve openness.

The first is that BRTAs can be used to pursue issues not currently within the scope of multilateral negotiations, that is, WTO-plus issues. For instance, Griswold (2003) argues that because of the difficulty in reaching a consensus amongst WTO members, BRTAs are useful for pairs or small groups of countries to reach agreements that are more ambitious in terms of tariff reductions (even if on a preferential basis), or in areas such as quarantine and technical barriers to trade, services, investment, electronic commerce, customs facilitation and labour and environmental standards. He further argues that such agreements can then provide a basis for either wider regional or multilateral negotiations. In a similar vein, DFAT, citing the WTO secretariat, suggested:

- FTAs have allowed groups of countries to negotiate rules and commitments that go beyond what was possible at the time multilaterally;
- in turn, some of these rules have paved the way for agreement in the WTO;
- services, intellectual property, environmental standards, investment and competition policy are all issues that were raised in regional negotiations and later developed into agreements or topics of discussion in the WTO. (sub. 53, p. 46)

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Similarly, some have argued that BRTAs could also be used by developing countries to start down the path to reform without having to realise the full adjustment costs that may arise from multilateral or unilateral reforms (Griswold 2003).

Another argument is that BRTAs can act in favour of multilateral reform though competitive pressures. Again, Griswold (2003) notes that the creation of an alternative approach may increase the impetus to reach a multilateral agreement. Similarly, Baldwin (1997, 2006) has argued that BRTAs can foster further multilateral reform because they advantage exporters, the natural proponents of free trade while simultaneously weakening key opponents of free trade, the import-competing industries. As such, he argues that such agreements can foster reform more generally. Similarly, he has argued that the multilateralisation of BRTAs can be stylised as a ‘domino theory of regionalism’. Under this approach, if an additional country decides to join a trade bloc this can, in turn, induce other non-members to join the trade bloc, as the enlargement of the PTA increases the benefits of joining. Baldwin has used this idea to explain the development of BRTAs in Europe.

### *Stumbling blocks?*

There are also several arguments that BRTAs can be stumbling blocks to further multilateral reforms. For instance, Bhagwati (2008) listed the following concerns on how preferential agreements could have a malign effect on multilateral negotiations.

- Those lobbying for specific lower barriers in a particular market could lobby for a preferential, rather than multilateral, agreement so that benefits are not diluted by ‘free riders’.
- Countries may maintain higher MFN tariffs as bargaining chips for negotiating preferential agreements.
- There is a limited number of skilled trade negotiators, so that bilateral and regional negotiations divert attention from multilateral negotiations.
- Multiple bilateral and regional agreements can exhaust trade reform goodwill, creating trade reform fatigue.

Some of these points have been included in submissions to this study. For instance, Lloyd submitted that:

The incentive effects which bilateral/regional agreements have must generally be towards weakening the incentives to multilateral liberalisation ... when bilateral/regionals do succeed in opening up significantly important overseas markets, they create an incentive to preserve the preferences gained; witness the opposition of ACP countries in the current Doha Development Round to “preference erosion”. (sub. 3, pp. 2–3)

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Another issue is that the BRTAs are subject to carve-outs for sensitive sectors, as with multilateral negotiations, as Elek submitted:

Unfortunately, there are very few comprehensive PTAs. The same products which are proving hard to liberalise in the WTO or APEC, are proving just as hard to tackle among smaller groups of economies. As Findlay et al. (2003) explain, it is harder to deal with sensitive sectors in PTAs among pairs, or small groups, of economies. Compared to multilateral negotiations, it is more difficult to overcome vested interests against reform. (sub. 44, p. 25)

Further, Ravenhill, following his examination of agreements in the Asia-Pacific region, argues that Baldwin's domino theory may have some explanatory power in the context of Europe, but that in the context of the Asia-Pacific, it does not:

The low utilization rates [among analysed agreements in the Asia-Pacific] suggest a great deal of indifference on the part of business to these agreements: they simply do not provide sufficient advantages for business to take the trouble to complete the documentation required for compliance with the rules of origin.

If the agreements do not create significant advantages for exporters in the partner economies, the corollary is that they do not generate significant disadvantages for exporting interests based in countries that are not parties to an agreement. Such a conclusion substantially undermines the logic of the "domino" effect. In reality, we see little evidence around the region of business clamouring for PTAs to "level the playing field". The character of PTAs in the region is not such, therefore, that they are likely to generate any automatic, self-sustaining momentum towards consolidation/multilateralization. (sub. 36, pp. 3–4)

Ravenhill also argues that because agreements have been tailored to accommodate domestic protectionist interests, there is substantial variation across agreements, further reducing the scope for multilateralisation.

Overall, the effects of BRTAs on multilateral trade liberalisation are unclear but, in any case, from an Australian point of view the issue is moot. The involvement or otherwise of Australia in BRTAs will have little effect on the extent of the global proliferation of bilateral and regional agreements, and hence Australian involvement in BRTAs is unlikely to have any effect on the multilateral trade liberalisation process.

#### FINDING 6.5

*While the incidence of preferential agreements has increased, their overall impact on multilateral liberalisation is not clear from available evidence.*

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## Reducing barriers unilaterally

There are a number of potential impacts of BRTAs on unilateral reductions of trade and investment barriers. On one hand, there is the building block argument that, as for the case of multilateral liberalisation, BRTAs, appropriately designed, can provide an option for countries to start down the path to reducing trade and investment barriers prior to undertaking more extensive unilateral (or multilateral) actions. On the other hand, there is a concern that BRTAs can inhibit unilateral reform as countries retain barriers to use as bargaining coin in BRTA negotiations.

In Australia's case, since the mid-1970s, there has been a strong history of liberalisation. For example, the effective rate of assistance for manufacturing has fallen significantly over the last 40 years (figure 4.3). While trade and investment barriers erected for domestic reasons are thus now relatively low, this has largely been the result of unilateral reform, rather than from multilateral reform or the entry into force of BRTAs.

As the Commission has commented previously (PC 2007), a concern with the effect of trade agreements is that the nature of negotiations, which operate on a 'give and take' basis, demand that a negotiating party be able to offer concessions to other parties in return for the concessions that they offer. This demand for negotiating 'coin' can create perverse perceptions of a country's trade barriers. There is the risk that the success of negotiations is judged with respect to the quantum of concessions offered by the other party, relative to those that are conceded. With this mindset, unilateral reforms are seen as a 'waste' of negotiating coin and support for unilateral reform is reduced.

In the context of Australia, trade barriers are already low. This lack of negotiating coin has been cited as a source of difficulty in conducting recent negotiations. For example, the Australian Fair Trade and Investment Network submitted that:

... Australia is not in a strong negotiating position, having previously reduced and minimised trade barriers such as tariffs on a unilateral basis. This means Australia's ability to influence change on a bi-lateral or regional basis is severely restricted. ... Australia is not in a position to be able to apply the required negotiating coin to obtain further benefits through the evolution of bi-lateral or regional free trade agreements. (sub. 33, p. 11)

While Australia has relatively few trade and investment barriers remaining, there is a possibility that these may be retained for the purposes of negotiating coin, hence impeding reductions in tariffs and other barriers to trade and investment, postponing economic gains that would otherwise be available to Australia.

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Agreements that confer preferences on other countries can also create external stakeholders in domestic policy settings. For instance, exporters in countries that receive preferential trade concessions have an interest in barriers not being lowered on an MFN basis to preserve the margin of preference negotiated under an agreement. By creating a third party stakeholder, reforms may be harder to enact. In fact, BRTA provisions may constrain the nature of future unilateral changes, including reductions in barriers, and may require renegotiating elements of existing agreements.

### **Flow-on effects on other bilateral and regional agreements**

Existing BRTAs can impact on the formation of later bilateral or regional trade agreements as a countervailing measure. For example, the National Farmers' Federation stated:

... the key driver of bilateral and regional trade agreements is the risk of being left behind. ... Australian farmers now face a raft of examples where, due to the vast number of bilateral and regional trade agreements now in place, they face a situation where they are or will be discriminated against due to trade agreements of which they are not a participant. (sub. 13, p. 9)

Existing agreements can also affect the scope of new agreements. For example, since negotiating an extensive agreement with the United States, subsequent negotiations by Australia have often incorporated similar provisions. While consistency in agreements has the potential to reduce the transactions costs of negotiating successive agreements and to multilateralise key elements, some argue that this will only be the case when the interests of the parties in successive negotiations are closely aligned. It would appear to be the case that, for Australia, its successive PTAs have not been entirely effective in achieving this goal. For instance, in the case of the recent AANZFTA, there are variations in commitments between members, such as the variation in tariff commitments illustrated in table 6.1, and there are variations between the commitments in AANZFTA and those negotiated bilaterally. Further, in some instances, the commitments have been greater under the earlier bilateral agreement than those agreed in the subsequent regional one.

### **Preventing backsliding**

As the Commission noted in its 2008-09 Annual Report, there has been a global trend towards more trade restricting policies in the wake of the global financial crisis (PC 2009a). There have been some increases in tariffs, although these typically have been either within bound levels, or by countries who are not WTO

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members. However, most of the increases in trade barriers have not been through increases in tariffs, but rather have been concentrated in areas where temporary measures are permitted. This includes measures such as anti-dumping duties, non-tariff barriers (for example, licensing conditions), domestic subsidies and domestic government procurement subsidies.

A potential function of BRTAs is the prevention of this ‘backsliding’ on reforms. That is, that even where agreements do not result in a reduction in existing barriers, they can be used to lock in current policies, restricting countries from increasing barriers in the future.

For instance, in the case of MFN tariffs, in many instances applied tariffs may be low, or even zero, but bound tariff levels might be quite high, and there is a risk that applied tariffs could be increased up to bound levels. Even where BRTAs do not reduce tariffs, or at least not immediately, they typically bind rates at the pre-existing applied levels (some of the commitments under AANZFTA are an example of this). In Australia’s case, its involvement in six BRTAs in which it has committed to eliminate its tariffs on imports from partner countries reduces the scope for a future Australian government to reverse the tariff reductions undertaken over the last three or so decades.

BRTAs can potentially also address some of the other forms of trade restricting measures. Some agreements, such as ANZCERTA, include restrictions on the use of anti-dumping measures. Further, provisions in agreements on non-tariff measures can reduce the scope for them to be used to restrict trade.

Participants to this study have cited a number of examples where BRTAs have locked in current arrangements, reducing uncertainty. For example, Telstra submitted that BRTAs:

... ‘lock in’ existing levels of domestic liberalisation, preventing parties from introducing more restrictive measures in the future. This increases certainty and reduces foreign investment risk. (sub. 31, p. 1)

Similarly, the Australian Dairy Industry Council noted that AUSFTA contained protections for Australian dairy exporters against potential new trade barriers:

Against this, AUSFTA does appear to provide Australian dairy exporters with some ongoing protection against the imposition of new trade barriers.

US dairy producers have, with variable degrees of commitment, advocated for quota limits to be imposed on imports of milk proteins for much of the past decade. These quotas would be additional to the restrictions already imposed on trade in skim milk powder. The USA is the world’s largest importer of milk protein concentrate, casein and caseinates. If the advocated quotas were imposed it would lead to a significant

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diversion of product into third country markets with an attendant depressing impact on world prices.

However, industry and government understand that the provisions of AUSFTA will require that Australian exports be excluded from any such action. (sub. 38, p. 6)

However, the scope of BRTAs to restrict the introduction of new trade restricting measures is still limited. Production and export subsidies typically<sup>2</sup> remain outside the scope of BRTAs and there has been an increase in these in response to the recent crisis, for example the United States has reintroduced export subsidies and increased price support for its dairy producers (PC 2009a).

In the case of government procurement, which is explicitly covered in many BRTAs, their effectiveness in stopping backsliding can be mixed. For instance, under the pretext of the global financial crisis, there have been moves to implement preferences for local suppliers by numerous countries including the United States and Australia (by the New South Wales Government). Under AUSFTA, Australian suppliers are granted a waiver from the domestic preferences under the ‘Buy American Act’. As an example, AUSFTA has countered attempts to mandate US state and federal governments purchase only US manufactured steel. However, there are still some restrictions, including sub-federal regulations that grant preferences to local suppliers (DFAT, sub. 53). Similarly, the agreement has not prevented local purchasing preferences being offered by the New South Wales Government through their ‘Local Jobs First Plan’.

Even where BRTAs are able to effectively ‘lock in’ policy changes, whether the effects are positive or negative will depend on whether the policy change agreed in the BRTA is beneficial. Lower tariffs are generally consistent with improved economic efficiency, but as discussed in chapters 10 and 14, some policy changes agreed to in Australia’s trade agreements are likely to entail net costs for Australia — extensions to patent life and copyright terms are an example. The binding of such changes through trade agreements makes what may, on further analysis, be desirable policy reversals more difficult to achieve.

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<sup>2</sup> An exception arises in the case of ANZCERTA, where the 1988 ‘Agreed Minute on Industry Assistance’ between Australia and New Zealand specified that both countries would avoid the use of measures that would have ‘adverse effects on competition between industries in the Free Trade Area’ such as export incentives, production bounties or other industry specific measures.

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## 6.3 Summing up

Australia's BRTAs have led to some clear reductions in trade and investment barriers between agreement partners.

While tariffs between partners on qualifying merchandise in PTAs have typically reduced to zero, long phase-in periods are not uncommon and there can be carve-outs of sensitive sectors. Further, some significant barriers that limit the ability to utilise reductions in barriers can remain, such as quarantine requirements and behind-the-border measures.

While it is widely recognised that there is a wide range of barriers to services trade and investment, immediate reductions in barriers under BRTAs can be limited. One exception is AUSFTA, which has resulted in much more substantive changes to investment barriers than those of the other agreements. While immediate reductions in services trade and investment barriers may be limited, agreements can create certainty by binding existing arrangements and can provide scope for future reductions in barriers, including through the use of MFN and ratchet clauses.

BRTAs can also have broader impacts on the liberalisation of trade and investment barriers, potentially influencing multilateral and unilateral reform, although these impacts are likely to vary significantly, depending on the nature of the agreements. Any effects on multilateral reform are largely a moot point for determining whether Australia should engage in BRTAs. However, given that unilateral actions have consistently been demonstrated to represent a substantial share of the gains available from trade liberalisation, such impacts are a consideration when deciding whether to pursue more BRTAs and, if so, how they should be designed (Part D).